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**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224**

Date: **MAR 13 2003**

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You state that your purpose is to promote the arts, by providing artists and art organizations with resources that they currently do not have, to fund themselves and to broaden their exposure. Your activities in furtherance of this purpose are:

1. **Licensing** – You state that [REDACTED]% of your activities will be engaged in licensing artists and art organizations. You state that licensing will allow artists to concentrate on their art and promote themselves through the selling of merchandise bearing their name. You state that your services relieve the artist or art organization of the money, time and risk involved in marketing and promotions. You state that you will be involved with other art organizations, e.g. [REDACTED], [REDACTED], [REDACTED], and film festivals with the intent of providing licensing services. Under your licensing agreement, you will retain the exclusive right to use and grant licenses for the use of the name, trademark, service marks, designs, logos, graphics and/or symbols on merchandise sold in connection with the marketing of the merchandise. You state that royalties and [REDACTED]% of the proceeds received will be paid to the individual artist or organization. The remaining proceeds will be retained by you.
2. **Merchandising** – You state that [REDACTED]% of your activities will be spent creating merchandise for sale based on the art of the artist or organization. You state that you will assist art organizations with merchandising of products by designing and creating products to be sold by the art organizations. You state that you will create the designs to the artist's or the organization's satisfaction using your in-house graphic designer. The merchandise will consist of calendars, soft goods, t-shirts, sweatshirts, tote bags,

mugs, blankets, cards, stationery and journals. The items will be sold wholesale to vendors, artists, and art organizations. Any sales to the general public will be at retail.

3. **Marketing** – You state █% of your activity will be spent marketing artists and art organizations and related merchandise. You state that your philosophy is the same as █, "to keep all of the teams (art organizations) strong through a unified effort." You state that you will organize the arts and do for artists and art organizations, what █ did for football. Using licensing and marketing, you plan to build a market presence for the artists and art organizations, allowing the artists, to concentrate on their art, freeing them from the entire merchandising cycle.
4. **Solicitation of Donations** – You state that █% of your activity will be devoted to solicitation and fundraising to provide you with the necessary funding to license several artists and/or art organizations. You state that you plan to solicit donations from banks, television stations, radio stations, newspapers, and insurance companies.

You will not be engaged in sponsoring or holding any art events such as art showings, gallery events, art sales, etc. You state that your activity may include co-sponsoring such events, if there is a potential to license any of the artists or organizations at the events.

You state that your primary fund raising activity will be licensing organizations, creating designs based on their trademarks, and producing merchandise to be sold wholesale at a profit.

You anticipate that it will require approximately \$█ in minimum working capital to increase your earned income, which you define as income derived from licensing activities. You state that you will approach individuals for private donations until you become self-supporting. You state that your need for private donations will diminish as the licensing of artists and art organizations grows.

You state that you are related to a for-profit entity, █ (EIN: █). █ is an S corporation whose business purpose is to support artists by providing them with a retail outlet for merchandise related to their artwork and to offer educational opportunities through classes and speakers. Information submitted indicates that you have an interlocking board of directors with █. You state that █ is one of your vendors, but that all transactions will be conducted at arm's length.

Section 501(c)(3) of the Internal Revenue Code provides an exemption from taxation for organizations organized and operated exclusively for charitable and educational purposes.

Section 1.501(c)(3)-1(b) of the Income Tax Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes; and does not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities, which accomplish one or more exempt purposes specified in section 501(c)(3). An organization will not be regarded if more than insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization, which is organized and operated for the primary purpose of carrying on an unrelated trade or business, is not exempt under section 501(c)(3) of the Code.

Section 513(a) of the Code provides that the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501. Such term does not include any trade or business: (1) in which substantially all the work in carrying on such trade or business is performed by the organization without compensation; or (2) which is carried on, in the case of an organization described in section 501(c)(3), by the organization primarily for the convenience of its members, students, patients, officers, or employees; or (3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Section 1.513-1(d)(1) of the regulations provides that, in general, gross income derives from "unrelated trade or business," within the meaning of section 513(a) of the Code, if the conduct of the trade or business is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities, which generate the particular income in question, and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has

causal relationship to the achievement of exempt purposes, and is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Rev. Rul. 66-178, 1966-1 C.B. 138 holds that an organization created to foster and develop the arts by sponsoring an annual public exhibit at which art works of unknown but promising artists are selected by a panel of expert judges and gratuitously displayed is exempt from Federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 68-167, 1968-1 C.B. 255 provides that an organization, which assists needy women in earning income by operating a market for these women to sell cooking and needlework is exempt from Federal income tax under section 501(c)(3) of the Code. Although the organization charged a small sales commission for services, it was not self-supporting and it served a charitable purpose by providing the market for the women to sell their products providing a source of income.

Rev. Rul. 71-395, 1971-2 C.B. 228 holds that a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code. The gallery was engaged in showing and selling the works of its own members and was used as a vehicle to advance their careers. It served the private purpose of its members contrary to the regulations.

Rev. Rul. 76-152, 1976-1 C.B. 152, clarifying Rev. Rul. 71-395 provides that an organization formed by art patrons to promote community understanding of modern art by selecting for exhibit, exhibiting, selling work and retaining a commission does not qualify as an organization described in section 501(c)(3) of the Code. The artists were directly benefited by the exhibition and sale of their work.

The information you have submitted establishes that your sole activity is to license the intellectual property of artists and art organizations. Such activity is typically conducted in a commercial manner. Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for charitable purposes if more than insubstantial part of its activities is not in furtherance of an exempt purpose. Unlike the organization in Rev. Rul. 66-178, *supra*, you do not gratuitously display artwork or sponsor events. You state that you will consider such activities only if there is an opportunity to provide licensing services to the artists or art organizations involved in the event. You state that your ■■■% of your total activities are licensing, merchandising and marketing of artists and art organizations and ■■■% of your

activities will be related to soliciting contributions. After you have reached your minimum working capital of \$[REDACTED] you will become self-supporting through only your licensing activities.

Unlike the organization in Rev. Rul. 68-167, *supra*, which provides a market for needy women to sell their handwork, you are not limiting your charitable class. You are providing services to anyone who wishes to pay you a service fee, represented by your share of the net proceeds from the sale of merchandise. The services result in the creation of ordinary consumer products that are sold to benefit the individuals or organizations contracting for such services. Section 1.501(c)(3)-1(e) of the regulations provides that an organization that engages in a regular business of a kind ordinarily carried on for profit is an unrelated trade or business and is not exempt under section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization may not be exempt if it is operated for the benefit of private individuals. Your activities are similar to those found in Rev. Rul. 71-375, *supra* and Rev. Rul. 76-152, *supra*. You are engaged in activities that benefit private individuals. It does not matter that those individuals are engaged in the arts.

Furthermore, you state that you are related to a for-profit organization, which will be engaged in business with you. While you state that all transactions will be at arm's length, it may not be the case as you have an interlocking board of directors.

The commercial purposes of your activities far outweigh your exempt purposes. Such activity is an unrelated trade or business and not in furtherance of an exempt purpose.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

[REDACTED]

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
TE/GE ([REDACTED])  
[REDACTED]  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) [REDACTED]

[REDACTED]  
Manager, Exempt Organizations  
Technical Group 2

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Code	[REDACTED]	[REDACTED]				
Surname	[REDACTED]	[REDACTED]				
Date	3/16/2003	3/16/03				